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FORMER JAPANESE PUBLIC CORPORATIONS: POST-PRIVATIZATION UPDATE

Summary

Although they have been "privatized" for several years, the best known Japanese public service corporations -- Nippon Telegraph and Telephone Corp., Japan Railways Group, Japan Airlines Co., Ltd. and Japan Tobacco Inc. -- are not free of government control. At the same time Tokyo has deregulated to varying degrees the markets that these ex-public corporations once considered their fiefdoms. Facing a newly competitive environment, these companies have responded with new services and diversification. Since privatization began in 1985 (see JEI Report No. 26A, July 12, 1985), the former monopolies have taken varied paths. Whether they have helped create a foundation for a strong future and for the ongoing development of Tokyo's privatization program remains to be seen.

Background

Japan has a tradition of state-owned and -managed service corporations, in contrast to the United States, where the government has limited its role in providing certain types of public services to granting monopolies or exclusive geographic areas of operation to the private sector (electric utilities, for example). Catching up with the West economically, technologically and, sometimes, militarily has occupied Japan since the late 19th century. One of the government's first modernization experiments, establishing the Japanese National Railways in 1872, succeeded in building not only a rail system but a private railroad industry as well.

The daunting task of rebuilding the economy's infrastructure after World War II, combined with the guiding influence of the American occupation advisers, led Tokyo again to resume its prewar direct hand in providing critical public services. A branch of the Ministry of Transportation was reorganized into JNR in 1949. Japan Tobacco and Salt Public Corp. was founded the same year by merging two government monopolies. Organized in 1951 as a special private corporation was Japan Air Lines Co., Ltd., with the Minister of Transportation's status as largest stockholder guaranteed by law. Two years later Kokusai Denshin Denwa Co., Ltd. was formed under the guardianship of the Ministry of Posts and Telecommunications. Nippon Telegraph and Telephone Public Corp. was founded in 1952 as a wholly owned government company; while modeled after American Telephone & Telegraph Co., including a research laboratory arm, it was barred from manufacturing telecommunications equipment. Although these five are the biggest and best known public corporations, Tokyo spawned more than a dozen other specialized firms to assist the postwar reconstruction effort, including Housing Loan Corp., Japan Development Bank, Export-Import Bank of Japan, Medical Loan Corp. and Environmental Sanitation Corp.

In the immediate postwar period Japan's system of public service corporations on the surface was similar to the mix of government-sanctioned monopolies and government-owned and -operated companies present in the United States. There were important differences, however. AT&T always has been a private company forced to meet shareholder expectations, while NTT was a government corporation beholden only to bureaucrats. JAL enjoyed greater privileges and support from Tokyo than Pan American World Airways or Trans World Airlines ever got from Washington in the early days of international aviation. JNR had no American equivalent until the 1970s when AMTRAK was formed and, even then, the comparison is a poor one. The American cigarette market is populated entirely by private firms unlike Japan's government monopoly on production.

While the Japanese economy was rebuilding and growing rapidly, these characteristics of Japanese public service corporations were not issues at home or abroad. The twin oil shocks of the 1970s, however, generated direct and indirect forces that would put these companies in the spotlight. As the economy slowed under the impact of oil price hikes, many public corporations revealed a lack of flexibility in either dealing with labor unions, setting new prices or altering services. NTT, JAL, JNR and JTS experienced deteriorating bottom lines, and alarms sounded within the government. Some observers blamed government control for stifling the firms' ability to take swift, corrective action. Others extended the government linkage further, saying that a monopoly backed by the deep-pocketed government has no incentive to cut costs and/or improve performance. In any case the performance of many public corporations, and the largest ones in particular, fell behind the private sector in the 1970s. JNR, in particular, began running up huge debts as management maintained unprofitable services, expanded high-speed rail lines into sparsely populated areas and failed to cut costs.

The indirect impact of the economic dislocations of the 1970s were not evident until the following decade. Tokyo had responded to the economic slowdown in textbook fashion by raising government spending. The huge amounts of

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debt issued to finance this spending binge drastically increased the central government's interest payments. As a new decade dawned, the debt-service costs, combined with concerns about inflation and future fiscal soundness, forced reassessments of both fiscal policy and the structure of government. Studies by several ad hoc committees on administrative reform culminated in a 1983 report that recommended reorganizing JNR, NTT and JTS into special firms with private management but stock held by the government and/or restricted to Japanese citizens. The prospect of privatizing the gargantuan JNR and NTT boggled the minds of many Japanese, but then Prime Minister Yasuhiro Nakasone was determined to shrink the size of government. He targeted April 1, 1985 as the privatization date for NTT and JTS, with JNR to follow two years later.

Mr. Nakasone's proposal set off a raging debate in and outside of Japan involving parochial interests as well as principles. While intrigued by the explosion of competition and innovation set off by Washington's deregulation of the airline, petroleum, financial services and telecommunications industries in the early 1980s, many Japanese were unimpressed with the chaos of bankruptcies and takeovers that went hand in hand with deregulation American-style. The breakup of AT&T was particularly messy from a Japanese perspective and served as a model of what not to do in the debate over NTT's future. Yet a consensus began to grow that the hand of government had become unnecessary and even counterproductive to the efficient provision of some public services. For the Japanese, who have traditions of deference to authority and of paternalistic government, this was something of a revolution in attitude.

As bureaucrats planned the transition from public monopoly to private competitor parochial interests began stirring. The affected ministries were aiming for as smooth a transition as possible. NTT and JTS, for example, were allowed to retain the majority of their assets, guaranteeing them a strong competitive position and preventing disruptions in service. In exchange, they were forced to maintain some unprofitable services or operations. Labor unions and opposition parties focused on job security and workers' rights in the new private firms, tying up passage of enabling legislation until their concerns were met. As a result, the newly private firms found their options tightly restricted from the start with regard to strike provisions, hiring and firing procedures and pension plans.

Foreigners saw quickly that privatization of NTT and JTS and deregulation of their lucrative markets represented a golden opportunity. Under intense pressure from Washington and European capitals Tokyo generally guaranteed foreign firms equal access to the newly deregulated telecommunications equipment and services and cigarette markets. American and European companies joined domestic competitors of NTT, while foreigners provide the only competition in the sale of cigarettes.

By accommodating both domestic opposition and foreign demands, Mr. Nakasone won Diet approval in 1984 of the privatization plans for NTT and JTS, effective the following April. Although not directly named in the legislation deregulating the domestic telecommunications equipment and services market, KDD lost its monopoly in the international telecommunications services area. (It remains a special private corporation, however, with the Japanese government as the largest shareholder.) Mr. Nakasone overcame strong labor union opposition to reorganizing JNR in 1987 by holding out privatization as the sole salvation for the debt-ridden railroad. JAL was freed from Tokyo's control (on

paper at least) in November 1987 when, following Diet repeal of the Japan Air Lines Co., Ltd. Law, the government sold its then 34.5 percent stake.

Tokyo's administrative reform program can claim, therefore, to have achieved the goal of reducing the government's size and its role in specific markets. Whether the program can be considered a success, however, is debatable. Several years of private management have had an obvious impact on these former public monopolies, but their results vary.

NTT: Avoiding a Breakup

When it was clear that Japan's domestic telecommunications market would be opened to competition, Japanese and foreign analysts predicted a boom in the offing. For a change, the prognosticators proved correct. Not only has the entry of new common carriers boosted inter- and intra-city telephone use, but a wide range of secondary service markets has sprouted. (For a review of Japan's telecommunications market, see JEI Report No. 46A, December 8, 1989.) Although NTT has used its new freedom to respond aggressively to new challenges, the results have been unsatisfactory to some. This dissatisfaction has generated calls for an AT&T-style breakup of NTT (see JEI Report No. 15B, April 13, 1990). After rallying its allies and some intense behind-the-scenes talks, a decision on a breakup was postponed earlier this year until at least 1995. NTT management realizes that the giant firm must fulfill bureaucratic and popular expectations if the threat of a breakup is to be permanently averted.

Competitive environment - Although the market was thrown open April 1, 1985, competitors in NTT's bread-and-butter markets did not appear until late 1986 (for leased circuits) and late 1987 (for telephone service). Since then more than a dozen firms have challenged NTT in every market segment, ranging from radio pagers to mobile telephones. Nevertheless, NTT continues to dominate every market in which it is active. While all three competing private common carriers managed for the first time to post net profits in the year ending March 31, 1990, NTT still recorded sales nearly 60 times greater than the largest of them. Even in the market for pocket-paging services, which is structured as a duopoly that pits NTT against one newcomer in each of two distinct geographic zones, NTT commands about a 75 percent market share nearly two years after the first of its competitors began offering services.

In secondary service markets competitors never allowed NTT's grip to become a stranglehold. Financially and technologically strong competitors, such as the Japanese subsidiary of International Business Machines Corp. and Japanese electronics makers, have built solid positions in the value-added network market. Although criticized for blocking technological innovation, the Ministry of Posts and Telecommunications has helped competitors overcome NTT's inherent advantages through its open-information policy for format and interface standards.

Financial Results - Reorganization may have slowed the growth of NTT's operating revenues since FY 1985 (see Table 1). The giant posted a 5 percent-plus gain in operating revenues in FY 1986 and FY 1987 but saw this increase dwindle to just over 3 percent the following two years. The rise in operating expenses, in contrast, has accelerated. As a result, the figures for operating income have been disappointing, hitting a peak in FY 1987 and then falling below the FY 1985 level in the business year ending March 31, 1990.

Table 1: Consolidated Financial Summary for Nippon Telegraph and Telephone Corp., FY 1985-FY 1989

(in millions of yen for the years beginning April 1)

	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Operating Revenues	Y5,091,409	Y5,353,582	Y5,662,001	Y5,841,897	Y6,022,359
Telephone	4,233,722	4,368,895	4,553,766	4,622,668	--
Telegraph	52,547	49,141	49,844	53,393	--
Leased Circuits	251,408	275,168	295,405	334,347	--
Data Communications	153,282	162,388	176,109	186,045	--
Terminal Equipment Sales	142,423	222,701	248,846	258,957	--
Miscellaneous	258,027	275,289	338,031	386,487	--
Operating Expenses	4,333,662	4,549,093	4,747,495	5,026,490	5,316,646
Personnel	1,748,804	1,837,353	1,877,527	2,030,231	--
Depreciation	1,469,094	1,419,619	1,390,886	1,458,736	--
Other	1,115,764	1,292,121	1,479,082	1,537,523	--
Note: Research and Development	136,209	149,255	181,718	221,692	--
Operating Income	757,747	804,489	914,506	815,407	705,713
Nonoperating Revenues	12,115	14,129	16,359	12,371	76,784
Nonoperating Expenses	396,441	407,707	354,408	307,891	271,950
Nonoperating Income	-384,326	-393,578	-338,049	-295,520	-195,166
Income Before Taxes	373,421	410,911	576,457	519,887	510,547
Income Taxes	187,733	218,248	309,270	256,275	236,800
Net Income	185,688	192,663	267,187	263,612	273,747
Total Assets	11,368,637	11,377,534	11,455,925	11,559,657	11,421,443
Current Assets	889,249	997,796	1,080,466	1,244,968	1,542,217
Fixed Assets	10,156,968	9,961,092	9,940,441	9,775,823	9,858,189
Other	322,420	418,646	435,018	538,866	21,037
Liabilities and Shareholders' Equity	11,368,637	11,377,534	11,455,925	11,559,657	11,421,443
Current Liabilities	1,555,078	1,575,512	1,651,159	1,650,816	2,021,051
Long-Term Liabilities	6,301,795	6,214,595	6,028,152	5,946,615	5,397,482
Shareholders' Equity	3,511,764	3,587,427	3,776,614	3,962,226	4,002,909

Source: Nippon Telegraph and Telephone Corp., Annual Report, 1987, 1989, 1990.

On the bright side, a tremendous jump in income from nonoperating sources in FY 1989 combined with a steady drop in nonoperating costs to pare the red ink for that year to almost half of the loss recorded five years earlier. Thanks to the abolition of special NTT tax levies and the freedom to plan for tax liabilities as if it were a private corporation, NTT has managed to hold down its tax bill. As a result, net profits have performed better than net operating income, showing growth over the past five years except in FY 1988.

As for its balance sheet, NTT's assets have not suffered from deregulation but neither have they benefited. The growth of total assets, which was just 1.7 percent between FY 1985 and FY 1988, actually turned negative in FY 1989 (down 1.2 percent). Management has been able, however, to pare NTT's long-term debt and boost shareholders' equity. The quality if not the quantity of NTT's assets, therefore, shows considerable improvement since reorganization.

Current Challenges - Despite its positive financial performance, NTT remains under fire from bureaucrats and the public alike. The Ministry of Posts and Telecommunications remains unhappy with management's approaches for cutting costs (particularly employment) and improving services. The ministry also is disappointed that NTT's domination of key markets so far has proved to be impervious to competition. Given that MPT continues to have a say in key areas (such as setting service rates) and that NTT's labor unions are backed by a much strengthened Japan Socialist Party, management may feel its hands are tied or at least sufficiently constrained to rule out bold moves. The world's largest private corporation finds itself in a paradoxical position: criticized by those who have some say in decisions for being too successful in some ways but not tough enough in others.

The public's unhappiness with the "new" NTT stems not from the quality of its service but from the plunging value of its shares. Tokyo hoped to auction off over several years at least one-half and as much as two-thirds of the 15.6 million shares issued when NTT went private. The first auction, held October 1986, was well-received; the price rose sharply from an initial Y1.2 million ($8,000 at Y150=$1.00) a share to a high of just over Y3.1 million ($20,667) in less than nine months. Since then, however, the price has drifted down, hitting Y2.6 million ($17,333) when the second batch of NTT stock went on the auction block in November 1987 and just Y1.9 million ($12,667) when Tokyo released a third tranche in October 1988. NTT stockholders did not escape the general pullback in the Tokyo Stock Exchange during the first quarter of this year, but their shares since have failed to ride the market's recovery. The per-share price closed at less than its debut level in mid-March (Y1.18 million or $7,867) and at precisely Y1 million ($6,667) in late July; since then it has sunk under this mark.

The declining price of NTT stock cannot be attributed to poor business results. Instead, the Recruit Cosmos Co., Ltd. influence-buying scandal and the resulting loss of public confidence in the government have stained the corporate giant. Former NTT president Hisashi Shinto allegedly tried to curry favor with then Prime Minister Nakasone by buying American supercomputers to help cool bilateral trade tensions. NTT reportedly turned around immediately and sold the machines (at a reduced price) to Recruit Co., Ltd., the parent company of Recruit Cosmos. When reports surfaced that key political figures and

businessmen had profited from insider trading of Recruit Cosmos stock, NTT's dealings came to light and the respected former NTT head was put on trial for bribery.

On top of this setback came a crisis of confidence as the once highly touted shares lost their promise of being a safe investment for individuals. Ninety-eight percent of all NTT shareholders are individuals, although they hold only 17.5 percent of all shares. While institutional investors may be capable of absorbing the paper loss of having invested in NTT shares, many individuals could afford only one share; they have had to watch helplessly as NTT's stock value has fallen.

Not surprisingly, there is a sense of outrage among individual NTT stockholders that the company and the government have failed to keep some unspoken pledge to support the price of NTT shares. Although the Ministry of Finance tacitly encouraged stockbrokers to support the shares immediately before the second and the third auctions, the inability of either the government or the securities industry to prevent the price slide has soured investors' attitudes toward the stock. MOF actually reduced the number of shares offered in the third sale to prevent weak demand from depressing the price even more, and in 1989 it scrapped the scheduled sale of government-owned shares because of the bear market. Plans for a stock auction this year -- when the last government-held shares to be offered to the public originally were expected to be sold -- are on hold as NTT and MOF search for an effective response to the erosion of public confidence.

Future Plans - Failure to respond adequately to the many challenges confronting NTT could tilt the scales in the debate over the organization's structure. Given five years by the government to answer critics and restore the public's and Tokyo's confidence in it, the giant corporation will be working hard to duplicate the results AT&T has achieved in recent years. The management of NTT feels that the best response is to redouble the company's efforts to provide top-quality services while continuing to produce good financial results. To achieve this goal NTT plans to improve its core local and long-distance telephone businesses but is not ignoring other opportunities.

- Visual, intelligent and personal communications - Integrating voice, visual and text transmission services is NTT's goal into the next century. Based on an integrated services digital network (ISDN), NTT's first step toward giving users "a flexible choice of a wider range of services" is expected to take advantage of a quadrupling in size of the information industry between 1986 and 2005, which is projected to increase from Y12.8 trillion ($85.3 billion) to Y50 trillion ($333.3 billion). Digital electronic media also are predicted to expand their share of the market. Telecommunications and data processing will account for 70 percent of the industry's income, up from the current 50 percent, the telecommunications segment alone will jump from Y5.7 trillion ($38 billion) to Y23 trillion ($153.3 billion).

NTT's communications network of the future will use sophisticated image-processing services to convey high-definition images, high-resolution text and graphics and eventually three-dimensional images to individual users. The network also will provide "intelligence" in the form of automatic translation, security, data and secretarial services. Finally, users will be free to personalize their communications services, picking from a wide range of options and then tailoring them to meet individual preferences.

• Research and development - To implement its VI&P communications concept, rapid development and introduction of new technologies are critical. NTT's strong commitment to R&D spending is one obvious signal of the high priority assigned to this area. Outlays jumped 22 percent in FY 1988, reaching Y221.7 billion ($1.5 billion). FY 1990 projections top Y240 billion ($1.6 billion). While continuing its strong tradition of applied research, NTT also is devoting greater attention to basic research, not only because Tokyo is promoting basic R&D but because it could give NTT entree to nontelecommunications fields, such as computer software and medical/diagnostic equipment.

• Noncore businesses - Like other large Japanese corporations, NTT is trying to bolster its bottom line by creating specialized subsidiaries. While NTT's affiliated firms mostly are related to its core businesses -- telecommunications consulting, terminal equipment sales and information services -- some are not. Advanced Energy Technologies Inc., for example, is a joint venture with a Canadian firm to develop rechargeable lithium batteries. Although NTT's noncore strategy will continue to emphasize areas that support its core businesses, it cannot afford to ignore promising opportunities.

KDD: No Longer A Backwater

Unlike NTT, Kokusai Denshin Denwa was not restructured in 1985 since private investors have held a majority stake from its founding in 1953. The law governing it was amended, however. Nevertheless, when the Japanese telecommunications market was deregulated, KDD faced a wrenching experience similar to NTT's. Alone among the major public service corporations, KDD remains a special private corporation and continues to serve as Japan's "official" international common carrier. The Ministry of Posts and Telecommunications retains a large say in KDD affairs by virtue of its status as the largest shareholder (10.9 percent) and because it holds the authorization necessary for KDD's operating plans. In response to the changing telecommunications market, however, KDD is showing signs of greater independence.

Competitive Environment - Because the December 1984 Telecommunications Business Law does not specifically bar competition, two companies are challenging KDD in the international telecommunications market. International Telecom Japan Inc. and International Digital Communications Inc. have provided leased circuit services to neighboring Asian countries and other areas since the spring of 1989 and telephone service since October 1989. While they lease circuits and ground facilities from KDD for much of their operations, the two companies are trying to build independent networks. No foreign-owned competitors are in this field. Moreover, the outlook is slim for any additional entrants (domestic or foreign) as MPT feels the market already is overcrowded. Foreign firms are represented, however, through IDC, which is backed by Britain's Cable & Wireless Plc and America's Pacific Telesis International Inc. as well as Toyota Motor Corp. and C. Itoh & Co., Ltd.

Although KDD's two competitors are running in the red (hardly surprising since start-up costs are astronomical), they are confident of turning a profit within a few years. KDD probably will continue to dominate the market even though MPT's regulations call for KDD rates to be about 23 percent higher than those of its rivals. MPT has allowed KDD to cut its rates, however, translating into gains for consumers.

Financial Results - As Table 2 shows, KDD's net profits fluctuated even as its operating revenues grew steadily, at least until FY 1989. The villain appears to be the healthy growth of operating expenses, which outpaced the increase in operating revenues for three of the past five years. KDD's management cited sharply rising costs for marketing, customer service, equipment and research as the main causes of FY 1989's meager results. Management also claimed that the relatively flat sales in the April 1989-March 1990 period stemmed from a loss of customers to ITJ and IDC.

Its mediocre profit picture has not prevented KDD from improving its balance sheet. Thanks to skyrocketing land prices and rising equity markets, KDD's investment portfolio looks solid. Portfolio growth could be more impressive if KDD engaged in active investment strategies, but MPT's control over the company's annual business plans leaves little freedom to do so. Nevertheless, management has controlled the growth of liabilities, leading to a steady increase in shareholders' equity. Clearly in sound shape, KDD appears lackluster only in comparison with the record earnings growth of private-sector firms in the past few years.

Current Challenges - KDD's operating venue is uncomplicated relative to NTT's. Because KDD provides a relatively narrow range of services and because certain international telecommunications organizations (Intelsat, Inmarasat and the International Telecommunications Union, for example) require that one organization be appointed as a country's national representative, there has been no discussion of breaking up KDD. Its most likely prospects are to remain a special private corporation because intimate links with MPT are necessary to deal with international telecommunications issues. This setup, however, is nowhere near that of the days prior to the April 1985 deregulation of Japan's communications markets since the amendments to the KDD law were successful to a degree in giving the company greater freedom to respond to new competition.

KDD's biggest challenge is to get a firm grip on costs. Close ties to MPT appear to have dulled KDD's competitive spirit. Management is trying to instill a sense of urgency among its workers. Always present in the background, however, is the perception that MPT will never allow KDD to fail. Overcoming this complacency is a major task.

Future Plans - Like NTT, KDD plans to meet the challenges ahead by improving its core operations and adding subsidiaries where appropriate. KDD's basic goal is "to provide a full range of responsive and reliable end-to-end international telecommunications services." By tailoring services to the specific needs of clients, providing easier billing and payment methods (credit card calls are now possible, for example), KDD is trying to keep existing corporate and individual customers. Among its new offerings are a group of packaged services for corporate users. PLANS (Private-Link Advanced Network Support) offers everything from consulting services to complete turnkey systems. Other new services include ISDN for overseas links plus specialized facsimile and data transmission services. Investment in new transmitters and receivers also is taking a large chunk of KDD's budget. New undersea fiber-optic cables and better onshore distribution networks are aimed at improving the quality and the availability of KDD's international services.

Developing and introducing new technologies is KDD's second key to improving its core operations. The organization is preparing equipment to handle

Table 2: Financial Summary for Kokusai Denshin Denwa Co., Ltd., FY 1985-FY 1989

(in millions of yen for the years beginning April 1)

	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Operating Revenues	Y216,066	Y223,987	Y248,460	Y258,346	Y258,719
Telephone	142,327	158,641	190,089	202,568	203,573
Other	73,739	65,345	58,370	55,778	55,146
Operating Expenses	179,610	192,959	207,468	215,264	226,920
Traffic and Commercial	44,551	48,522	52,741	53,935	57,830
Maintenance	24,802	28,007	29,252	28,554	29,132
Administration	35,350	33,619	34,973	36,794	34,079
Research and Development	4,916	4,595	4,802	4,942	4,708
Depreciation	35,226	39,529	41,245	42,969	46,083
Domestic Network Charges	33,561	35,729	39,632	44,683	50,608
Other	1,201	2,956	4,819	3,384	4,477
Operating Income	36,455	31,027	40,991	43,081	31,798
Nonoperating Revenues	6,933	15,203	13,170	16,571	11,397
Nonoperating Expenses	-2,662	-11,520	-9,233	-4,995	-5,897
Nonoperating Income	4,271	3,683	3,937	11,576	5,500
Income Before Taxes	40,725	34,709	44,927	54,657	37,297
Taxes	23,570	22,687	29,609	32,481	23,159
Net Income	17,155	12,022	15,318	22,176	14,138
Total Assets	364,489	430,860	466,944	461,041	489,785
Property and Investments	270,738	300,077	326,380	319,883	332,901
Current Assets	93,751	130,782	140,563	141,158	156,883
Liabilities and Shareholders' Equity	364,489	430,860	466,944	461,041	489,785
Fixed Liabilities	81,995	142,658	156,183	134,931	137,946
Current Liabilities	56,676	53,223	62,625	58,748	73,574
Shareholders' Equity	225,817	234,978	248,135	267,362	278,264

Source: Kokusai Denshin Denwa Co., Ltd., Annual Report 1990.

international transmission of high-definition television signals and is working on improving long-distance fiber-optic transmission systems. International video conferencing, improved satellite systems and computerized network management systems also are coming to market from KDD's research laboratories.

A very conservative approach marks KDD's diversification agenda; top priority is given to those ventures that will help KDD's core businesses. There is room for operations aimed at improving the bottom line, however. Initial attempts to branch out were timid. Telecomet International Inc. was founded in 1984 to peddle KDD's international telecommunications expertise at home and abroad. TELEHOUSE International Corp. of America and TELEHOUSE International Corp. of Europe, Ltd. were formed to lease space to house and provide support services for private international communications equipment (aimed at the needs of Japanese firms expanding overseas). Other examples of supporting subsidiaries are VIDEOCOM International Corp., KDD Teleserve Inc. and KDD Academy Inc. (The latter two provide language translation and training services.)

Newer ventures include Kokusai Information Service Co., Ltd., which markets Japanese and foreign data base services; OSI Plus Corp., which develops software based on the Open Systems Interconnect standard; and KDD Technology Corp., which seeks to spin off products and services from KDD's telecommunications and information processing technologies. Kokusai Marine Engineering Corp., which conducts marine surveys for submarine cables and other projects, and KDD Development Corp., which develops KDD's real estate assets, are two examples of subsidiaries geared to noncore activities.

JAL: Free to Fly or Fall

Commercial aviation is an area where free market principles usually have been subordinated to the interests of national security or sovereignty. The rigid bulwarks of national interests stand out with particular clarity in international aviation agreements. Postwar Japan developed an airline system similar to many European countries: a single international carrier and several domestic carriers. The American experience with airline deregulation in the early 1980s modeled the benefits and the risks of introducing free market mechanisms. As American carriers increased competitive pressures (thanks to deregulation's spread to international service) and the European Community's impending unification impelled continental airline companies to form alliances and/or merge, Tokyo began to scramble to restructure its airline industry.

Competitive Environment - Japan Airlines, as it now is called, was the nation's sole scheduled international carrier until halfway through the 1980s. The Minister of Finance held 49 percent of the stock at JAL's founding in 1951 as a special private corporation; the rest was sold to Japanese nationals. Private firms -- All Nippon Airways Co., Ltd. and Japan Air System Co., Ltd. (previously known as Toa Domestic Airlines) -- were allowed to carve up the domestic market. International passenger competition between JAL and the two domestic carriers was limited to unscheduled charter flights to a handful of foreign countries and domestic segments of JAL's international routes. In addition, cargo carriers were restricted to domestic service.

This cozy situation changed in May 1985 when Japan and the United States concluded an interim package of amendments to the 1952 bilateral civil aviation

accord. (See JEI Report No. 13A, April 1, 1988 for a full discussion of bilateral civil aviation issues.) Not only did the accord break JAL's monopoly on international cargo service (Nippon Cargo Airlines Co., Ltd. was given transpacific rights), but it also opened the door for ANA and JAS to begin scheduled international passenger service. The pact also increased the number of foreign competitors in both the passenger and the cargo segments of Japan's aviation market. Faced with what amounted to a fait accompli, the Diet voted in September 1987 to abolish the Japan Air Lines Co., Ltd. Law, which was scheduled to expire in any case in mid-November 1988. The government sold its then 34.5 percent share of JAL in November 1987 for Y664.5 billion ($4.4 billion). JAL is not entirely free of the government's sway, however. A replacement JAL law went into effect as the old law expired. While the new firm has complete control over its internal structure, its annual operating plans still must be approved by the Ministry of Transportation.

The level of competition in domestic and international service has increased sharply since 1985. JAL now goes head-to-head with ANA and JAS on most domestic routes. JAS returns the compliment to many Asian destinations, and ANA is building its routes to the United States and Europe. At least seven American companies battle JAL for the booming transpacific passenger and cargo business; numerous other foreign carriers vie for rights to serve Japan. With its large fleet of planes and well-established network of overseas offices, JAL is in no danger of being overwhelmed. The issue is whether it can prosper.

Financial Results - On a nonconsolidated basis JAL has bounced back from the losses suffered in FY 1985 and FY 1986 because of depressed passenger revenues. Operating revenues rose 13.3 percent in FY 1989 to just under Y1.1 trillion ($7.1 billion), but the growth in net profits faltered, slipping 4.4 percent to under Y16.6 billion ($10.5 million). The picture on a consolidated basis (Table 3) is similar, although data for FY 1989 are lacking.

Passenger and cargo revenues have risen in line with the economy's current expansion, which started in 1986. Tokyo's promotion of consumer spending and the growing affluence of the average citizen have generated a boom in overseas tourism. Exports (and more recently imports) of high-value/small-size items, especially semiconductors, and perishable goods have kept cargo bays full. Less volatile exchange rates also have helped the bottom line. The transition to an entirely private enterprise in the FY 1987-FY 1989 period was conducted smoothly, with immediate consequences for some line items. Sales and advertising expenditures, for example, rose strongly in FY 1988, as did funding for new equipment. Most interesting is the surge in financial investments; the new JAL has both the freedom and the willingness to squeeze a higher return out of all its assets.

Current Challenges - Despite this relatively rosy picture, JAL's management faces several difficult tasks. In common with the other ex-public companies, labor issues are a problem. Outsiders criticize JAL for having too many people in management and administration and not enough pilots, flight attendants and ground crews. Foreigners make up an important part of JAL's flight crews, particularly as pilots. JAL is responding with improved training programs, but service expansion is likely to outpace the supply of pilots for some time.

Table 3: Financial Summary for Japan Airlines Co., Ltd., FY 1985-FY 1989

(in millions of yen for the years beginning April 1)

	Consolidated				Unconsolidated	
	FY 1985	FY 1986	FY 1987	FY 1988	FY 1988	FY 1989
Operating Revenues	Y924,808	Y875,716	Y972,070	Y1,091,568	Y935,746	Y1,060,315
Passenger	625,062	605,179	671,636	753,708	700,014	793,413
Domestic	156,227	157,979	187,949	211,661	196,227	227,891
International	468,835	447,200	483,687	542,047	503,787	565,522
Cargo	185,330	162,729	166,095	169,531	159,921	161,287
Domestic	18,953	20,292	23,070	25,539	20,768	20,294
International	166,377	142,437	143,025	143,992	139,153	140,993
Other	114,414	107,806	134,337	168,297	75,809	105,615
Operating Expenses	896,981	835,722	904,650	1,005,417	862,982	986,313
Flight Operations	543,177	522,022	559,760	592,467	677,432	769,453
Sales and Other Costs	353,804	313,700	344,890	412,950	185,550	216,860
Operating Income	27,286	39,994	67,419	86,150	72,763	74,002
Nonoperating Revenues	8,057	6,917	7,929	12,060	10,775	25,607
Nonoperating Expenses	-38,207	-42,785	-37,828	-46,148	-40,662	-46,863
Nonoperating Income	-30,151	-35,868	-29,899	-34,088	-29,888	-21,256
Income Before Taxes	-2,324	4,125	37,520	52,061	42,875	50,820
Income Taxes	2,278	12,000	18,526	32,590	25,545	29,124
Net Income	-4,088	-7,480	19,442	20,183	17,330	16,573
Total Assets	865,507	970,609	1,060,268	1,217,054	--	--
Current Assets	251,619	282,660	321,345	443,532	--	--
Fixed Assets	493,681	561,563	597,428	588,637	--	--
Other Assets	120,205	126,382	141,492	184,883	--	--
Liabilities and Shareholders' Equity	865,507	970,609	1,060,268	1,217,054	--	--
Current Liabilities	316,359	355,101	350,888	380,950	--	--
Long-Term Liabilities	342,215	411,676	480,653	486,840	--	--
Other Liabilities	64,743	69,000	74,019	80,376	--	--
Shareholders' Equity	142,189	134,830	154,706	268,886	--	--

Source: Japan Airlines Co., Ltd., Annual Report, 1987, 1989, 1990.

At headquarters JAL has tried to reshuffle management to end internal divisions and infighting. During JAL's long and intimate relationship with the government, factions mirroring various bureaucratic interests within the Ministry of Transportation developed and came into conflict with groups representing other interests. A June 1989 reorganization of the board of directors and subsequent personnel shifts, targeted at reducing MOT's influence on JAL, have yet to make a clear difference regarding internal strife. Many airline analysts have questioned whether the shift simply indicated that one faction had gained the upper hand for the moment. While everyone agrees that infighting wastes energy and prevents JAL from reacting quickly to new demands, no one has an immediate solution.

Another challenge is to repair a corporate image tarnished by the 1985 crash of a jumbo jet on a domestic flight. Although a faulty bulkhead repair made by Boeing Co. employees was determined to be a cause of the crash, JAL's reputation for safety was damaged. Management responded with programs and advertising that put safety above all else, even profits. While passenger loads have returned to satisfactory levels, JAL knows that it cannot relax its vigilance in this area.

Future Plans - JAL's late 1987 rebirth as a fully private firm set the airline on new paths and recommitted it to traditional goals. Investment in a state-of-the-art fleet of aircraft is seen as a sharp weapon in the intensifying battle to gain passengers and keep operating costs down. For example, JAL -- already operating the world's largest fleet of Boeing 747's -- has firm orders for 40 of the current-generation 747-400 series, which needs only a two-person cockpit crew and offers a 10 percent-plus improvement in fuel efficiency over the 747-300 model. In addition, JAL has placed firm orders for 10 of the MD-11 transport made by McDonnell Douglas Corp.

Better ground equipment also forms an important part of JAL's strategy. New maintenance and repair facilities not only will keep its fleet in top shape but may help win a share of maintenance contracts from other airlines. JAL also is investing in automating many labor-intensive maintenance and repair operations. A new $8 million washing device allows a four-person crew to clean a 747 jet in an hour, an operation that done manually requires many more workers and several hours; a specially designed vehicle has cut the number of service personnel needed to replace an aircraft wheel from three to one; and a robot window polisher eliminates the costly process of removing scratched windows for replacement.

JAL's AXESS computer reservation system is the most visible part of the firm's Y130 billion ($866.7 million) medium-term plan to develop advanced software and hardware systems to provide better service to customers. In cooperation with American Airlines, JAL is working on better transaction-processing software for reservations systems.

Among the former public service corporations JAL has the most aggressive diversification plans. Management has set of goal a raising revenues from diversified operations to 50 percent of the parent corporation's revenues by FY 1992. JAL has 17 consolidated subsidiaries (five of which are wholly owned) and a minority interest in another 144 companies. Of special interest to JAL is the hotel and leisure industry, which complements its core operations. JAL is not afraid of ranging far afield from the travel industry, however. It is opening

a chain of Western-style restaurants in Japan and is launching its own brand of uniforms for Japanese grade schoolers in cooperation with designers in London, Paris, Milan, Madrid and New York. Although many ventures are intended to fatten profits, others are aimed at giving employees managerial experience as well as providing a place for excess employees.

Most interesting, internationalization has spread to JAL's financing operations. The company has made active use of the Euromarket for straight and warrant bonds; it also taps the commercial paper market in Japan. In addition, JAL has opened financial subsidiaries to help JAL group firms obtain better financing. It is actively restructuring its long-term debt to cut interest costs and is seeking to maximize return on all its financial assets.

Japan Tobacco: Trying Not to Get Burnt

Although government monopolization of the production and the distribution of tobacco products seems odd to Americans, it is a common feature in Asia. While American cigarette makers long had been interested in Japan's market, that country's growing bilateral trade surplus with the United States brought a new intensity to American demands for access. After sometimes acrimonious talks dating back to the mid-1970s, the Diet passed legislation in the summer of 1984 restructuring Japan Tobacco and Salt into what became Japan Tobacco in April 1985. On the same date, Tokyo opened the import and wholesale business to foreign and domestic firms alike. Restrictions on sales outlets for foreign products essentially were eliminated as well. The pricing formula for imported cigarettes also was changed in April 1985 in response to foreign complaints that imported products were treated unfairly, and two years later the tariff on cigarettes was scrapped. JTI retains a monopoly on the production of tobacco products in Japan, but foreign cigarettes have steadily chipped away at its market share -- in part because JTI is required to buy all domestically grown leaf, much of it low quality.

The salt business emerged unchanged from the April 1985 JTS restructuring; salt production remains a government monopoly. And, while JTI lost the reference to salt in its name, it still must obtain the Ministry of Finance's approval for all salt-related business plans and operations.

Competitive Environment - Unlike the other ex-public corporations, JTI faces a stagnant market. Total cigarette sales were up less than 2 percent in FY 1989 to about 320 billion pieces. An increase in the number of female smokers is expected to counter much of the projected decrease in smoking by men. With little change in the overall size of the market, foreign sales are taking their gains out of JTI's hide.

Three foreign firms have made the biggest inroads into Japan's cigarette market. Phillip Morris Inc. (which sells Lark, Parliament and Merit brands) led the pack with an estimated 8.3 percent market share in FY 1989, followed by Brown & Williamson Tobacco Corp. (maker of Kent and Lucky Strike brands) at 3 percent and R.J. Reynolds Tobacco Co./M.C. Tobacco Co. (Vantage brand) at 1.9 percent. With all other imports accounting for about 1 percent of the market, foreign brands made up about 14 percent of overall consumption in the April 1989-March 1990 period. Observers predict that this share will rise to 20 percent within a few years.

Nevertheless, JTI's dominant market position is likely to persist for the foreseeable future. Its Mild Seven family of products continues to account for more than 40 percent of all cigarette sales in Japan. Combined with its other domestic brands -- Cabin, Caster, Seven Stars and SomeTime -- and foreign-licensed brands -- Marlboro, Peace, Frontier, Hi-Lite and Hope -- JTI commanded a little less than 86 percent of the Japanese market in FY 1989. The only foreign product to make the list of 10 best-selling cigarette brands was Lark Milds in tenth place.

Financial Results - JTI has posted mixed results over the past several years (Table 4). Earnings have been drifting lower for several years, while outlays for sales and marketing have been rising. Profits from diversified operations still are too tiny to affect the bottom line, yet JTI plans to sink more money into other new ventures. Management admits that the profit picture is not bright but contends that the firm should be in the black over the long run.

Table 4: Nonconsolidated Financial Summary for Japan Tobacco Inc., FY 1982 and FY 1987-FY 1988

(in billions of yen for the years beginning April 1)

	FY 1982	FY 1987	FY 1988
Net Sales	Y2,815	Y2,798	Y2,724
Tobacco and New Businesses	2,722	2,727	2,654
Salt	93	71	70
Cost of Sales	2,544	2,453	2,366
Cost of Goods Sold	759	660	630
Tobacco Excise Taxes	778	1,794	1,735
Transfer to National Treasury	1,007	--	--
Gross Profit	271	345	358
Selling, General and Administrative Expenses	184	231	254
Operating Profit	87	114	105
Nonoperating Income (Expenses)	6	8	-20
Income Before Taxes	93	122	85
Income Taxes	--	85	47
Net Income	93	37	38

Sources: Japan Tobacco & Salt Public Corp., Annual Report 1984, and Japan Tobacco Inc., Annual Report 1989.

Current Challenges - JTI finds itself in the awkward position of promoting to an increasingly health-conscious public a product that significantly increases the likelihood of certain diseases. By restricting advertising and requiring stronger health warnings on tobacco products, the government is not making sales easier. Finding a solution to this paradox is a major concern of management.

Responding to the challenge of imported brands also occupies planners at JTI. New products, lower production costs and increased emphasis on exports are being juggled in an attempt to hold the line against foreign cigarettes. Given that JTI must use inferior domestic leaf (which it blends with leaf purchased overseas) and the cachet of foreign brands, which domestic brands cannot match, a 20 percent foreign market share projection seems conservative.

Export market development also poses some tough questions. Antismoking sentiment in advanced and developing countries is gaining strength, threatening ambitious expansion plans. While the Eastern European and the Soviet markets are attracting interest from American and Western European tobacco firms, JTI has yet to make a move into these potentially lucrative areas.

Future Plans - JTI cannot abandon its core tobacco business and is pouring money into more efficient production equipment and product development. It also is trying to improve the quality of domestic leaf through biotechnology. These core operations have spawned a number of promising business lines, including manufacturing consulting, machine engineering services and a line of agricultural products, such as seeds, fertilizers and pesticides. JTI also pins much hope on its prescription and over-the-counter pharmaceuticals business.

To counter its unhealthy image JTI is expanding into the health improvement industry. It has opened a chain of health clubs and introduced a line of health and sport drinks. JTI's HalfTime beverages also boast several products that feature herb-derived flavorings. Food products appealing to the health conscious are another avenue of diversification. JTI has ventures in the mushroom business (Fuji BioFarm Corp.), a noodle and processed meat maker (JT Agris Corp.) and a joint restaurant venture (Chicago Foods Corp.)

Japan Railways: Working Out From Under a Mountain of Debt

The Japanese National Railways' reputation for excellent service is well justified. While state-of-the-art high-speed bullet trains (shinkansen) are Japan's pride, the frequency and punctuality of its regular train service is the heart of the system. Despite this operating efficiency, JNR was in disastrous financial shape at the start of the 1980s; its cost structure was way out of line in comparison with private competitors. In the final two years before its April 1987 restructuring JNR lost more than Y3.2 trillion ($21.3 billion), bringing its total short-term debt to Y14.1 trillion ($94 billion) and its long-term debt to Y23.6 trillion ($157.3 billion). It is not hard to understand why the government wanted to uncouple itself from JNR and why it took time to develop a reorganization plan that would have a good chance of success. A government commission studied the situation for two years and found a host of problems: JNR was overregulated, uncompetitive, unresponsive, too big and plagued by poor labor-management relations.

Adopting the commission's recommendations without change, JNR became the Japan Railways Group: six passenger lines -- East Japan Railway Co., Ltd., Central Japan Railway Co., Ltd., West Japan Railway Co., Ltd., Shikoku Railway Co., Ltd., Kyushu Railway Co., Ltd. and Hokkaido Railway Co., Ltd.; a freight company (Japan Freight Railway Co., Ltd.); a firm to lease bullet trains to the passenger companies and to support new bullet train construction (Shinkansen Holding Corp.); a holding company to handle JNR's debts (JNR Settlement Corp.); and three new subsidiaries -- the Railway Technical Research Institute, Railway Telecommunication Co., Ltd. and Railway Information Systems Co., Ltd.

JNR's assets -- 200 rail lines, 13,000-plus miles of track, 45,500 rail cars (passenger and freight), 4,600 stations, 226 square miles of land and Y41.5 billion ($276.7 million) invested in 155 nonrail enterprises -- were divied up among the new companies. Employment by the new group was immediately cut by 61,000 to 215,000. Also divied up was JNR's short- and long-term debt: JNR Settlement took Y25.6 trillion ($170.7 billion), Shinkansen Holding shouldered Y5.7 trillion ($38 billion) and the remaining Y5.9 trillion ($39.3 billion) was spread among JR East, JR Central, JR West, Railway Telecommunication and Railway Information Systems. Although the six passenger rail companies now technically are private firms, the government is the only stockholder; this is expected to change in the near future.

Competitive Environment - In contrast to other public corporations that were privatized, JNR always had competition in the passenger market. The competition remains fierce. Private passenger railways have nearly an equal number of stations (4,949) and almost the same amount of rolling stock (22,057 cars) as JR. Yet they carry nearly two-thirds of all passenger traffic (12.6 billion) with half the employees (113,700). JR still faces stiff competition in urban markets but practically none in rural areas. Competitive pressures keep JR from raising fares in high-volume markets. At the same time it is unable to completely eliminate unprofitable rural routes. The competitive challenge has not changed; rather, JR has changed to meet the competition.

Financial Results - The reorganization has been a stunning success (see Table 5). All six passenger lines broke even in their first year of operation -- FY 1987; as a group they earned Y50 billion ($333.3 million) after taxes. In FY 1988 JR East and JR Central recorded net incomes of Y41.4 billion ($276 million) and Y35.2 billion ($234.7 million), respectively, and the six as a group showed a net profit of Y86.1 billion ($574 million). Results for FY 1989 indicated that JR East (net profits of Y66.7 billion or $444.7 million), JR Central (net income of Y57.2 billion or $381.3 million) and JR West (net profits of Y25.7 billion or $171.3 million) remained healthy. (Financial results for the other three companies were not available.) As a result, the three JR passenger rail companies that inherited JNR debt were able to reduce their share by Y468.3 billion ($3.1 billion) in FY 1988 to Y3.9 trillion ($26 billion) and, although data are not available, the debt probably was cut even more in FY 1989 as profits rose.

JR's freight business also is in the black, showing pretax income of Y4.6 billion ($30.7 million) in FY 1989, a gain of Y1.2 billion ($8 million) over the previous year. JNR Settlement is not expected to earn a profit but rather work down the mountain of debt inherited from JNR and any new debts from service expansions. So far, new debts have outpaced income from real estate sales and payments from other JR Group firms. Interest payments reportedly amount to some Y3 billion ($20 million) a day, and the total debt had crept up to Y37.5 trillion ($250 billion) as of the end of March 1990. Shinkansen Holding enjoys firm leasing revenues from the passenger companies but is piling up debt because of new construction projects. The nonrail JR members are likely to be in the red as they still are pouring money into start-up operations.

Current Challenges - Working down the inherited debt will remain a top priority for some time, but other factors could delay progress. For example, Tokyo has put pressure on JNR Settlement to slow or postpone the sale of properties to help cool the superheated real estate market. The profit-oriented passenger rail firms naturally will resist using their income to speed payments on the debt.

Table 5: Selected Data on Passenger Operations of Japanese National Railways and Japan Railways Group

(in units as indicated)

	JNR FY 1986	JR Group FY 1988
Operating Revenues (billions of yen)	Y3,027	Y3,717
Net Income (billions of yen)	Y-1,361	Y86
Passenger Line Network (kilometers at end of fiscal year)	21,194	20,933
Passenger-Kilometers (millions)*	198,299	204,678
Passengers (millions)*	7,104	7,356
Train-Kilometers (millions)*	549	552
Rolling Stock-Kilometers (millions)*	4,150	4,065
Stations (number at end of fiscal year)*	4,591	4,894

*JR Group data covers FY 1987.

Sources: Management and Coordination Agency, Japan Statistical Yearbook 1989, and East Japan Railway Co., Ltd., Fact Book 1989.

In addition, JR still must contend with the pork-barrel politics that lead to immensely expensive expansion into sparsely populated areas. The recently completed Seikan tunnel, which links the main island of Honshu with the northern island of Hokkaido, is a marvel of engineering; its cost was so high, however, that it never can be economical. Political pressure reaches even to research activities. A test track for a magnetically levitated and driven train will be built in the home district of a powerful politician and has ignited a land speculation frenzy there that has pumped up the cost of the project. It is unlikely that the JR Group will ever be free of political influence, a situation that threatens whatever gains private management makes.

Moves to pare JR's work force raise concerns not only with its labor unions but with the public as well. Approximately 2,600 workers cut in the 1987 reorganization have yet to be reemployed. Tiring of the nonproductive payroll expense, JNR Settlement issued dismissal notices to the laid-off staff, effective April 1, 1990. Labor unions and politicians were outraged since the action goes against several labor relations boards' rulings that the workers should be rehired by the new JR companies. Although the dispute is in mediation, it has besmirched the new JR and reignited labor tensions.

An emerging problem is the performance disparity between the passenger rail companies that serve the main island of Honshu -- JR East, JR Central and JR West -- and the firms that serve the smaller islands of Hokkaido, Kyushu and Shikoku. The disparity is not surprising since economic activity is centered

between Tokyo and Hiroshima, an area served by all three Honshu JR firms. The volume of traffic on the smaller islands makes it unlikely that the companies serving these areas ever will be as healthy as the three mainland lines. Whether this will force another reorganization in the future is unclear.

Future Plans - The JR Group is committed to improving the quality of its service and equipment while cutting costs. New engines and specially designed cars that appeal to tourists is one area of intense development. Another is improvements to the shinkansen trains, increasing their energy efficiency, hauling capacity and speed from the current 150 miles per hour average. Computerized yard operations and signaling systems continue to be refined, while computerization of reservations, ticketing and information services proceeds. The jewel in the Railway Technical Research Institute's crown, however, is the experimental maglev train with projected top speeds of up to 325 mph. Bringing the prototype to commercial use is expected to cost at least $25 billion and take until the turn of the century.

The nonrail JR Group companies are the other weapons in the battle for profits. Because the cost of land in Japan is so high, Railway Telecommunication has an advantage over competitors if its railway ties enable it to lease more cheaply the right to lay communications cables along JR rights-of-way. The firm is busy laying a fiber-optic network and hopes to become a major player in the communications industry. Railway Information Systems certainly will be one of the fiber-optic network's first users, providing value-added processing services to other JR companies and outsiders. The JR passenger firms also are expanding into nonrail businesses, particularly into services located in railway stations. Fast-food outlets, sundry stores and newsstands are natural extensions for the rail companies and provide outlets for excess employees.

A key milestone in the group's attempt to evolve into truly private companies will be a successful stock offering to the public. Based on their profitable performances both JR East and JR Central are eligible to list their shares on the Tokyo Stock Exchange. JR West and Japan Freight Railway hope that their performance this year will bring them up to snuff. Analysts estimate that the first sale of JR East and JR Central stock, now scheduled for the fall of 1991, could bring in between Y9.4 trillion and Y12.5 trillion ($62.7 billion to $83.3 billion), welcome news to a Finance Ministry that is growing very concerned over JR Group's mounting debt load. JR and Ministry of Transportation officials now are engaged in discussions about how to avoid the NTT-syndrome of inflated stock price expectations.

Part of this strategy includes freeing each JR company from government oversight as it goes public. The JR Company Law presently requires each JR firm to obtain MOT approval of board member appointments, fund-raising operations and annual business plans. MOT had hoped to retain these powers until the government had sold all its JR Group shares. Tokyo Stock Exchange officials argued that each JR company must be freed from these onerous requirements when each is sold to the public to improve the attractiveness of the offer. MOT apparently has heeded the TSE's advice and announced in early August that the necessary amendments to the JR Company Law would be ready for the 1991 sale.

To address concerns about foreign influence over an important national asset, MOT will place 30 to 40 percent of any publicly offered shares in the hands of friendly, stable shareholders. Even if foreigners do gain a say in the management of a JR firm, MOT still has the power to regulate fares and service.

The Debate Continues

The privatization of public service corporations and the liberalization of markets they once monopolized have yielded clear benefits in the Japanese context. Consumers are enjoying lower prices and more choices for telephone service, air transportation and cigarettes. Market newcomers, both Japanese and foreign, have brought innovative services to consumers while turning a profit. The government has made significant progress toward its goal of spurring competition in these areas and freeing itself of the obligation to back money-losing operations.

Besides expanding foreign opportunities in Japan's markets, privatization and liberalization have had a positive effect on relations with trading partners by removing sources of tension. American tobacco companies, for example, are satisfied that the Japanese market no longer is closed to them. The same generally is true in the telecommunications and air transport markets, although flare-ups still are possible. In a more general sense the Japanese system of public service corporations is now closer to the American than the European model. While the similarities cannot be attributed to the wholesale adoption by Tokyo of American views on the role of government, it does indicate the differences between Washington and Tokyo on the subject of privatization are narrower than those between the United States and most European nations. Whether this leads to greater U.S.-Japan cooperation on related issues is unclear.

Although Japan's experience has been smoother than similar actions in America, the transition from government to private ownership has not been painless for the organizations involved or for the government and the consumer. Efforts by new management to reduce labor costs has been particularly painful to a nation that prides itself on social harmony. Japanese consumers have had to adjust to the new complexity of previously simple services, just as American consumers were bewildered by the breakup of AT&T. On balance, however, most Japanese would agree that the changes have been beneficial.

Whether privatization should be extended to the remaining government-owned corporations now is under discussion. Although privatization might yield improved efficiency, intimate ties to government are central to the functions of certain organizations, such as the Japan Development Bank and the Export-Import Bank of Japan. Other government companies by their nature are unprofitable and could not survive as private operations. Rural development agencies and some small business support organizations are examples of this group. For other government corporations, however, the shift to private status is a viable option. The government's housing loan business, the national hospital system and the postal savings system all have been floated as candidates for privatization. Tokyo's most likely approach will be to bide its time, monitoring the progress of the companies that already have been privatized with an eye toward applying the experience elsewhere. It does appear, however, that a permanent shift has taken place in Japanese attitudes toward the role of government in providing public services.

For further information, contact Jon Choy.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.